In The

# Supreme Court of the United States



October Term, 1975

No. 75-660 1

L. JOHN JACOBI and ROBERT GAMBERA, individually, on behalf of the members of the AMERICAN ASSOCIATION OF SECURITIES REPRESENTATIVES, and on behalf of all other securities representatives similarly situated,

*Petitioners,*

*vs.*

BACHE & CO., INC., WALSTON & CO., INC.; THOMSON & McKINNON AUCHINCLOSS, INC. (formerly THOMSON & McKINNON, INC.); HORNBLOWER-WEEKS, HEMPHILL. NOYES; LOEB, RHOADES & COMPANY; TUCKER, ANTHONY & R. L. DAY; HARRIS, UPHAM & CO., INC.; DOMINICK INT'L. CORP.; HALLE & STIEGLITZ, INC.; GOODBODY & CO., INC.; BEAR, STEARNS & CO.; LEHMAN BROS.; KIDDER PEABODY & CO., INC.; R.W. PRESSPRICK & CO., INC.; DEAN WITTER & CO., INC.; W.E. HUTTON; REYNOLDS & CO.; PAINE, WEBBER, JACKSON & CURTIS; SCHEINMAN, HOCKSTIN & TROTTA, INC.; PRESSMAN FROLICH & FROST, INC.; NEWBURGER, LOEB & CO.; RAUSHER, PIERCE SECURITIES CORP.; OPPENHEIMER & CO.; STEINER ROUSE & CO., INC.; L. F. ROTHSCHILD & CO.; SPENCER TRASK & CO.; SMITH BARNEY & CO., INC.; and THE NEW YORK STOCK EXCHANGE, INC.,

*Respondents.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

ABRAHAM E. FREEDMAN
*Attorney for Petitioners*
346 West 17th Street
New York, New York 10011
(212) 929-8410

CHARLES SOVEL
*Of Counsel*

(8868) LUTZ APPELLATE PRINTERS, INC.
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*Respondents.*

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

To the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners, L. John Jacobi and Robert Gambera, individually, on behalf of the members of the American Association of Securities Representatives, and on behalf of all other securities representatives similarly situated, respectfully pray that a Writ of Certiorari issue to review the final judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled matter on August 5, 1975.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit dated August 5, 1975 is not yet officially reported, but is printed in the Appendix hereto (1a). The opinion of the United States District Court for the Southern District of New York is reported at 377 F. Supp. 86 (S.D.N.Y. 1974), and is printed in the Appendix hereto (23a).

## JURISDICTION

The judgment of the United States Court of Appeals for the Second Circuit was entered on August 5, 1975 and is printed in the Appendix hereto (20a). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## QUESTION PRESENTED

Where the New York Stock Exchange established a rule prohibiting its member firms from paying commission to their



registered representatives based on a service charge which the member firms charged their customers, a rule which was not subject to SEC review and therefore not within the New York Stock Exchange's implied immunity from the antitrust laws, and this rule was a price fixing scheme and therefore a *per se* violation of the antitrust laws, was it not error for the court below to hold that *per se* rules of antitrust liability were not to be applied to the securities industry?

## STATUTORY PROVISION INVOLVED

The statutory provision involved is Section 1 of the Sherman Act, 15 U.S.C. §1, and is printed in the Appendix hereto (47a).

## STATEMENT OF THE CASE

During the period from April 2, 1970 through March 24, 1972, the New York Stock Exchange (hereafter "NYSE") had in effect a Rule which required that member firms of NYSE charge their customers, in addition to the prescribed minimum commission, a service charge equal to $15 or 50% of the regular commission, whichever was less, on purchases or sales of securities in orders of 1,000 shares or less. Through the operation of other provisions of the NYSE Constitution and the Rules and Regulations of the NYSE Board of Governors adopted thereunder, the member firms of the NYSE were prohibited from paying commission to the salesmen in their employ (commonly referred to as Registered Representatives or Securities Representatives) based on the amount of this service

charge.[1] As a result, the Registered Representatives employed by defendants were denied compensation to which they otherwise would have been entitled.

The within action was instituted on behalf of a class defined as the Securities Representatives employed by the broker defendants during the period from April 2, 1970 through June 25, 1971 against the NYSE and several of its member firms to recover commissions based on the amount of the service charge collected by the broker defendants on transactions initiated by the members of the class. The basis on which relief was sought was that the provision of the NYSE Constitution (Article XV, Section 9) pursuant to which supposed competitors, the member firms of the NYSE, agreed or were required to act uniformly in not paying commission based on the service charge was a form of horizontal price fixing or price stabilization among competitors for the purchase of services (in this case the services of Registered Representatives) and therefore a *per se* violation of Section 1 of the Sherman Act, 15 U.S.C. §1.

At trial defendants offered two principal defenses. First, defendants argued that the NYSE, in adopting the provision which prohibited paying commission on the service charge, was acting within the scope of its self-regulatory authority under the Securities Exchange Act of 1933 and, therefore, it and the member firms were "immune" from antitrust liability. Second, defendants argued that the "rule of reason," rather than *per se* rules of antitrust liability, applied to this case, and that plaintiffs had failed to establish that prohibiting payment of commissions

1. See NYSE Constitution, Article XV, Sections 1 and 9. NYSE Board of Governor's Rule 347(a).



based on the service charge was an "unreasonable" restraint of trade.

The District Court found in favor of defendants, holding, first, that the "rule of reason," rather than *per se* rules of antitrust liability applied, and, second, that the regulation prohibiting payment of commission based on the service charge was immune from antitrust challenge because it "furthered the purposes of the securities laws," see 377 F. Supp. at 96-97. Thereafter, while this case was pending on appeal to the Second Circuit, this Court handed down its decision in *Gordon v. New York Stock Exchange, Inc.*, ——U.S.——, 95 S. Ct. 2598 (1975). On the basis of this Court's decision in *Gordon,* the Court of Appeals for the Second Circuit reversed the District Court's finding of antitrust immunity, concluding that SEC jurisdiction to review the rule in question "existed only at the periphery of its jurisdiction and the SEC disclaimed the exercise of any power of review" (14a).[2]

However, even though the Court of Appeals found that there was no basis for finding antitrust immunity, it held that the fact that the securities industry was a regulated industry operated to "displace" traditional *per se* rules of antitrust liability that would be applicable to non-regulated industries. Thus, the Court of Appeals stated:

> "This seems to us to mean that within the area of supervised self-regulation contemplated

2. It should be noted that the Registered Representatives had complained to the SEC about the rule which prohibited them from receiving commissions based on the service charge, and the SEC replied that it had taken no position with respect to whether member firms could pay commissions based on the service charge and that this was a matter for the individual firms to determine for themselves.

by the Securities Exchange Act *per se* concepts are generally displaced and the courts are to examine whether the particular restraint, even though it would be a *per se* violation if performed by others, was reasonable" (15a).

The Court of Appeals then held that the complaint should be dismissed because plaintiffs had failed to prove that the restraint in question was "unreasonable."

Since the NYSE prohibition on paying commissions based on the service charge was a restriction on the freedom of action of supposed competitors in their pricing and compensation policies, it would be a *per se* violation of the antitrust laws were a non-regulated industry involved. Thus, the single question presented by this petition is whether the fact that the securities industry is a regulated industry operates to displace *per se* rules of antitrust liability in those areas which are outside the area of SEC regulation and therefore not immune from antitrust liability.

## REASONS FOR GRANTING THE WRIT

### I.

**The decision below is in conflict with this Court's decisions in *Gordon v. New York Stock Exchange,*——U.S.——(1975) and *Silver v. New York Stock Exchange,* 373 U.S. 341 (1963), and severely limits the efficacy of the antitrust laws as applied to the securities industry and other regulated industries.**

Any decision affecting the liability of the NYSE under the antitrust laws raises issues of extreme national importance



because the NYSE is the nation's largest securities exchange and transactions occurring on it affect millions of people.[3] In the instant case, a review of the decision below is of even greater importance because the rationale of the Second Circuit's decision that *per se* rules of antitrust liability do not apply to regulated industries will affect all regulated industries and materially limit the efficacy of the antitrust laws in maintaining competition in our economy.

In *Silver v. New York Stock Exchange,* 373 U.S. 341 (1963), this Court rejected any broad exemption from the antitrust laws for the securities industry. Rather, this Court established the principle that exemption of the securities industry from the antitrust laws would be implied ". . . only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." See 373 U.S. at 357. Last term this Court, in *Gordon v. New York Stock Exchange, Inc.,* ——U.S.——(1975), held that the antitrust immunity of the securities industry extended only to those areas which were subject to review by the Securities Exchange Commission under Section 19(b) of the Securities Exchange Act of 1933, 15 U.S.C. §78s(b). Absent the availability of SEC review of exchange activity, no antitrust immunity was to be implied.

Prior to this Court's decision in *Gordon,* the NYSE contended that its self-regulatory activities were immune from the antitrust laws solely by virtue of the fact that its Constitution

3. The NYSE is the largest organized securities market in the United States. It transacts well over 70% of the dollar value of all stock transactions on exchanges in the United States. See *Thill Securities Corp v. NYSE,* 433 F.2d 264, 265-266 (6th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971).

and Rules were submitted to the SEC, without regard to whether the SEC had authority under the Securities Exchange Act to prohibit a particular rule or regulation. Under this position, there was a large "no-man's land" where there was both antitrust immunity because the conduct in question was regulated by a NYSE rule or regulation, and no SEC review because the conduct in question was not cognizable under Section 19(b) of the Securities Exchange Act. This Court's decision in *Gordon*, eliminated this "no-man's land" by equating the area of antitrust immunity with the availability of SEC review under Section 19(b) of the Securities Exchange Act.

There is nothing in the *Gordon* decision which even remotely suggests that this Court, in eliminating the "no-man's land" of antitrust immunity, contemplated that it would be replaced by a new "no-man's land" where established *per se* rules of antitrust liability would not be applied, and in which "reasonable" price fixing would be permitted. In fact, this Court's prior decisions were directly to the contrary, with *per se* rules of antitrust liability being applicable to the securities industry to the same extent that they were applicable to non-regulated industries in the absence of some basis for conferring antitrust immunity. The *Silver* decision itself was based on a holding of *per se* antitrust liability. As this Court noted in *Gordon v. New York Stock Exchange, Inc., supra*, 94 S. Ct. at 2611-2612:

> "The starting point for our consideration of the particular issue presented by this case, *viz*, whether the antitrust laws are impliedly repealed or replaced as a result of the statutory provisions and administrative and congressional experience concerning fixed commission rates, of course, is our decision in *Silver*. There the court considered the relationship between the antitrust laws and the Securities Exchange Act, and did so specifically with respect to the action of an exchange in ordering its members to remove private direct telephone connections with the offices of a nonmember. *Such action, absent any immunity derived from the regulatory laws, would be a per se violation of §1 of the Sherman Act.* 373 U.S., at 347, 83 S. Ct. at 1251. Concluding that the proper approach to the problem was to reconcile the operation of the antitrust laws with a regulatory scheme, the Court established a 'guiding principle' for the achievement of this reconcilation. Under this principle, 'repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary.' Id., at 357, 83 S. Ct. at 1257." (Emphasis supplied.)



Notwithstanding the clear language of both *Silver* and *Gordon*, the Court below interpretated *Silver* as holding that *per se* rules of antitrust liability were "generally displaced" by the rule of reason in the securities industry, relying on a portion of this Court's opinion in *Silver* which refers to "the aegis of the rule of reason." However, this reference in *Silver* to the "aegis of the rule of reason" was in the context of the Court's discussion of the issue of antitrust *immunity*, with the Court indicating that

the implied immunity from the antitrust laws which the securities industry derived from the regulatory scheme of the Securities Exchange Act of 1933 was but a particular application of the principle of the rule of reason. This Court did not hold that, in the absence of such immunity, *per se* rules were not applicable; on the contrary, the holding in *Silver* was precisely the opposite with the opinion beginning with the statement that the conduct there in question was a *per se* violation of the Sherman Act absent some justification derived from the policy of another statute, see 373 U.S. at 347.

*Per se* rules of liability were introduced into the antitrust laws to relieve the courts from the obligation of pursuing elaborate and often fruitless evidentiary inquiries, and from having to make economic judgments which they were not equipped to make. See *Northern Pacific Railroad Company v. United States,* 356 U.S. 1 (1953). These considerations are no less applicable to regulated industries than they are to non-regulated industries.

Horizontal agreements among competitors have been universally held to be *per se* violations, see *United States v. Topco Associates, Inc.,* 405 U.S. 596 (1972), and ever since this Court's decision in *United States v. Trenton Potteries Company,* 273 U.S. 392 (1927), it has been established law that price fixing is a *per se* violation of the Sherman Act. The evil of a price fixing scheme lies not in the price that is fixed but in its interference with the free play of market forces. It is this interference which the Sherman Act proscribes, *United States v. Socony-Vacuum Oil Co.,* 310 U.S. 150, 221-222 (1940). Since the reasonable price of today may become the unreasonable price of



tomorrow, *United States v. Trenton Potteries Company, supra,* 73 U.S. at 397, the reasonableness of a price fixing scheme, or the economic necessity which may be advanced to justify it, are of no moment, *United States v. Socony-Vacuum Oil Co., supra,* 310 U.S. at 218, 220. For "absent some 'immunity bath', *all* price fixing is illegal, if within the purview of the Federal antitrust laws," *Crane Distributing Company v. Glenmore Distilleries,* 267 F.2d 343, 345 (6th Cir. 1959). A price fixing scheme is either immune or it is not immune. There is no middle ground where non-immune "reasonable" price fixing is permitted.

The rule prohibiting payment of commission based on the service charge in the instant case was a price fixing scheme because it restrained competitors from acting independently in compensating their employees. As Judge Mansfield noted, in denying defendants' motion to dismiss in this case:

> "There can be little doubt about the fact that if a group of employers, as the complaint here alleges, were allowed, not as part of a collective bargaining agreement, to agree together to reduce the commissions paid to their respective employees, they would have the same power to restrain competition as is inherent in a price-fixing agreement." *Cordova v. Bache & Co.,* 321 F. Supp. 600, 606 (S.D.N.Y. 1970)

The effect of the decision below is to create a new "no-man's land" in which regulated industries are permitted to engage in "reasonable" price fixing in those areas where they are not subject to regulation. As such, it is contrary to this Court's

prior decisions and represents a severe encroachment into the scope of the protection afforded by the antitrust laws. Accordingly, the issue presented is of major importance to the administration of both the antitrust laws and the securities laws and warrants the granting of a Writ of Certiorari.

## CONCLUSION

For all the foregoing reasons, it is respectfully submitted that this petition for a Writ of Certiorari should be granted.

s/ Abraham E. Freedman
*Attorney for Petitioners*

Charles Sovel
*Of Counsel*



## OPINION OF THE UNITED STATES COURT OF APPEALS

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 377—September Term, 1974.

(Argued December 19, 1974 Decided August 5, 1975.)

Docket No. 74-2001

L. John Jacobi and Robert Gambera, individually, on behalf of the members of the American Association of Securities Representatives, and on behalf of all other securities representatives similarly situated,

*Plaintiffs-Appellants,*

v.

Bache & Co., Inc.; Walston & Co., Inc.; Thomson & McKinnon Auchincloss, Inc. (formerly Thomson & McKinnon, Inc.); Hornblower & Weeks-Hemphill, Noyes; Loeb, Rhoades & Company; Tucker, Anthony & R. L. Day; Harris, Upham & Co., Inc.; Dominick Int'l Corp.; Halle & Stieglitz, Inc.; Goodbody & Co.; Bear, Stearns & Co.; Lehman Bros.; Kidder, Peabody & Co., Inc.; R. W. Pressprich & Co., Inc.; Dean Witter & Co., Inc.; W. E. Hutton; Reynolds & Co.; Paine, Webber, Jackson & Curtis; Scheinman, Hockstin & Trotta, Inc.; Pressman Frolich & Frost, Inc.; Newburger, Loeb & Co.; Rauscher, Pierce Securities Corp.; Oppenheimer & Co.; Steiner Rouse & Co., Inc.; L. F. Rothschild & Co.; Spencer Trask & Co.; Smith Barney & Co., Inc.; and The New York Stock Exchange, Inc.,

*Defendants-Appellees.*

Before:

FRIENDLY, TIMBERS and GURFEIN,

*Circuit Judges.*

Appeal from a judgment of the District Court for the Southern District of New York, Robert J. Ward, *Judge*, 377 F. Supp. 86 (1974), after a bench trial, which dismissed a class action under the antitrust laws brought by registered representatives against the New York Stock Exchange and member firms.

Affirmed.

CHARLES SOVEL, ESQ., New York, N.Y. (Abraham E. Freedman, Esq., New York, N.Y., of Counsel), *for Plaintiffs-Appellants.*

MARVIN SCHWARTZ, ESQ., New York, N.Y., and WILLIAM E. JACKSON, ESQ., New York, N.Y., *for Defendants-Appellees.*

*Of Counsel:*

Sullivan & Cromwell; James H. Carter, Esq., and Richard Urowsky, Esq., *for Defendants-Appellees Bache & Co., Inc.; Kidder, Peabody & Co., Inc.; Dean Witter & Co., Inc.; Smith, Barney & Co., Inc.; and Dominick International Corp.*

Seward & Kissel; Anthony R. Mansfield, Esq., and Kenneth J. Kelly, Esq., *for Defendant-Appellee Rauscher Pierce Securities Corporation.*

Simpson, Thacher & Bartlett and Lindsay A. Lovejoy, Jr., Esq., *for Defendants-Appellees Lehman Bros. and Tucker Anthony & R. L. Day.*





Milbank, Tweed, Hadley & McCloy; Russell E. Brooks, Esq., and Mark L. Davidson, Esq., *for Defendant-Appellee New York Stock Exchange, Inc.*

Winthrop, Stimson, Putnam & Roberts; Stephen A. Wiener, Esq., and Theodore Weitz, Esq., *for Defendants-Appellees Bear, Stearns & Co. and R. W. Pressprich & Co., Inc.*

Gifford, Woody, Carter & Hays; L. Mifflin Hays, Esq., and Louis Proyect, Esq., *for Defendant-Appellee Harris, Upham & Co.*

E. Michael Growney, Jr., Esq., *for Defendant-Appellee Spencer Trask & Co., Inc.*

Shearman & Sterling; Lansing R. Palmer, Esq., and George J. Wade, Esq., *for Defendant-Appellee W. E. Hutton.*

Hall, McNicol, Marrett & Hamilton and William C. Bieluch, Jr., Esq., *for Defendant-Appellee Thomson & McKinnon Auchincloss Inc.*

Breed Abbott & Morgan and Joseph P. Dailey, Esq., *for Defendant-Appellee Walston & Co., Inc.*

Nathan Leventon, Esq., *for Defendant-Appellee Steiner, Rouse & Co., Inc.*

Moses & Singer and Joseph L. Fishman, Esq., *for Defendant-Appellee L. F. Rothschild & Co.*

Spear & Hill; Eliot Lumbard, Esq., and Laurence Grosberg, Esq., *for Defendant-Appellee Reynolds & Co.*

Bressler, Meislin, Tauber & Lipsitz and Steven Lipsitz, Esq., *for Defendant-Appellee Pressman Frolich & Frost, Inc.*

Beekman & Bogue and Milton Weiss, Esq., *for Defendants-Appellees Hornblower & Weeks-Hemphill Noyes; and Paine, Webber, Jackson & Curtis.*

Brown, Wood, Fuller, Caldwell & Ivey; Roger J. Hawke, Esq., and Thomas J. Mullaney, Esq., *for Defendant-Appellee Goodbody & Co.*

Cahill, Gordon & Reindel; David R. Hyde, Esq., and George Wailand, Esq., *for Defendant-Appellee Loeb, Rhoades & Company.*

Fried, Frank, Harris, Shriver & Jacobson and Leslie A. Blau, Esq., *for Defendant-Appellee Halle & Stieglitz, Inc.*

Finley, Kumble, Heine, Underberg & Grutman and Herbert Roth, Esq., *for Defendant-Appellee Newburger, Loeb & Co.*

Guggenheimer & Untermyer and Marvin E. Pollack, Esq., *for Defendant-Appellee Oppenheimer & Co.*

FRIENDLY, *Circuit Judge:*

This appeal is from a judgment of the District Court for the Southern District of New York, 377 F. Supp. 86 (1974), which dismissed a treble damage class action under the antitrust laws, 15 U.S.C. §§ 1 and 15, against the New York Stock Exchange (NYSE) and twenty-seven member



brokerage firms (member firms). It raises questions upon which we believed the decision of the Supreme Court in *Gordon* v. *New York Stock Exchange*, —— U.S. —— (1975), 43 U.S.L.W. 4958, would shed light. The Court having decided *Gordon* on June 26, 1975, we now deal with the more difficult problem here presented.

I.

The action was brought by two registered representatives on behalf of all such representatives employed by the defendant firms subsequent to March, 1970 who were compensated at least in part by commissions on securities transactions which they caused to be effected on NYSE.[1] The significance of the March, 1970 date is that it immediately preceded a period when NYSE required imposition of a "service charge" of "not less than the lesser of $15 or 50%" of the minimum commission, for transactions involving less than 1,000 shares.

Historically member firms had compensated registered representatives by paying them a percentage of the commissions charged to their customers, although such compensation was integrated with or complimented by a variety of salary, bonus and incentive payments. The percentages, and the mix of such commissions with other compensation arrangements, varied from firm to firm; the district court stated that "the parties do not dispute that competition [for the services of productive representatives] was in fact intense." 377 F. Supp. at 89.

What gave rise to the present controversy was this: Article XV, § 1 of NYSE's Constitution, which required member firms to charge minimum commissions, also provided:

1 Class action status was recognized by order dated November 1, 1971.

> No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a rule adopted by the Board of Governors, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member or allied member of the Exchange or member firm or member corporation.

Article XV, § 9 provided:

> Members of the Exchange, member firms and member corporations shall make and collect, in addition to minimum prescribed commissions, such other minimum charges with respect to accounts and services as the Board of Directors may from time to time prescribe. Except as may be specifically permitted by a rule adopted by the Board of Directors . . . no bonus or percentage of such charges, whether such charges be the minimum charges prescribed by the Board or greater charges, shall be given, paid, or allowed, directly or indirectly, or as a salary or portion of a salary to a clerk or to any member of the Exchange, member firm or member corporation, or to any other person, firm or corporation for business sought or procured for any member of the Exchange, member firm or member corporation.

The apparent force of Article XV, § 1, had been greatly weakened by Rule 347(a), adopted by the Board of Governors, which provided:

> Pursuant to Section 1 of Article XV of the Constitution, registered representatives may be compensated as follows:



> (1) registered representatives—on a salary or a commission basis,
>
> (2) branch office managers—on a salary or a commission basis; also, with the prior approval of the Exchange, they may receive a percentage of the net profit of the branch office,
>
> (3) a registered representative who is also head of a department of the organization—may, with prior approval of the Exchange, receive a percentage of the net profit of his department, and
>
> (4) bonuses—registered representatives may participate, with the prior approval of the Exchange, in bonus distributions.

However, since Rule 347(a) did not refer to service charges, the prohibition of Article XV, § 9, against passing on any portion of a service charge remained in force, although its impact was largely theoretical since, before the matter here in dispute, the last service charge had expired in 1940.

During late 1969 and early 1970, NYSE firms were experiencing diminished profits or actual losses on their trading business, owing, they contended, to the absence of any increase in general commission rates since 1958, see *Gordon* v. *New York Stock Exchange*, —— U.S. at ——, 43 U.S.L.W. at 4961. This experience occurred at a time when the exchanges and the SEC were engaged in general discussions about the commission rate structure. NYSE determined that, as an emergency measure to meet what was considered to be a crisis, the additional charge described above should be imposed on transactions of less than 1,000 shares, as to which the existing flat rate commission structure was thought to yield returns incom-

mensurate with costs. We are told that the decision to call this a service charge rather than an added commission was a result of the fact that the Board of Governors could impose such a service charge merely by changing the rules whereas an increase in commissions would demand an amendment to the NYSE Constitution, which would take six to eight weeks to effect.

SEC Rule 17a-8(a) provides:

> Each national securities exchange shall file with the Commission three copies of a report of any proposed amendment or repeal of, or any addition to, its rules not less than three weeks (or such shorter period as the Commission may authorize) before any action is taken on such amendment, repeal or addition by the members of such exchange or by any governing body thereof.

Pursuant to that rule the president of NYSE on March 19, 1970 forwarded to the Commission copies of a proposed new Rule 383 embodying the service charge. On the same day he distributed the proposed new rule to members with an explanatory statement. This included the following:

> Although firms should be aware that since this is a minimum service charge, the Exchange Constitution does not permit the charge to be shared in the form of compensation to member firm registered representatives, we would remind firms that they may continue to follow their individual policies in sharing the minimum commission with their sales personnel.

Chairman Budge of the SEC responded on April 2. He stated that the Commission would not object to the new rule as an interim measure for a 90-day period only. He added:



> The Commission expressly predicates its nonobjection to the interim increase in charges upon its expectation that the Exchange will take all steps necessary to assure that full brokerage services for small investors are restored and that transaction size and other limitations on such accounts imposed in the last year by the Exchange's membership will be removed. We also expect that the Exchange will undertake to make certain that the additional revenues produced by the interim surcharge will be received by the member firm obtaining the customer's order and will be prudently employed by its member organizations to improve their operations and financial position.

The Board of Governors thereupon adopted a new Rule 383 imposing the service charge, effective April 6 through July 5, 1970.[2]

On May 19, 1970, the Association of Investment Brokers, a trade association of registered representatives, sent a telegram to the SEC requesting the Commission to cause NYSE to direct member firms to include the service charge with commissions in computing the compensation paid to registered representatives. Chairman Budge answered with a letter dated June 22. This paraphrased the SEC's April 2 letter of non-objection, a copy of which was enclosed, and went on:

> The Commission has not interfered with the various compensation arrangements which firms have with their salesmen. We believe that this is a matter for determination by each firm with its registered representatives subject only to the qualification that they

---

2 This embodied certain changes, including repeal of any restrictions on the execution of small orders, necessary to conform to the SEC's requirements.

> act prudently to improve their operations and financial condition where such action is warranted. However, as always, the Commission stands ready to receive evidence from interested persons which demonstrates, with particularity, that additional regulatory action on our part is necessary or appropriate for the protection of investors.

During June, discussions between NYSE and the SEC were also being held, in which NYSE sought an extension of the service charge until October 3, 1970. The Commission advised that, while it objected to an extension of the service charge to a fixed date, it would not take action to prevent an indefinite extension provided that this would be terminated if the Commission so required.[3] NYSE agreed. The Commission then held public hearings, in which two spokesmen for registered representatives appeared. One stated "that the imposition of the service charge and the direction by the Stock Exchange that the registered representatives not be permitted to share in that service charge, which rule was not objected to by the Securities and Exchange Commission, is a gross injustice to the registered representative . . . ." SEC counsel interrupted to say that the Commission had not taken a position on the use of the service charge as a basis for computing the compensation of registered representatives and referred to the Chairman's June 22 letter. When the other spokesman took the stand, SEC counsel introduced a form letter sent by the staff to registered representatives who had written the Commission; in substance it repeated the June 22 letter. The service charge remained

3 Apparently the SEC's preference for this type of extension was due to a desire to avoid the procedures that would otherwise arise from § 19(b) of the Securities Exchange Act.



in effect until March 24, 1972, when a revised commission schedule took effect.

At trial, plaintiffs contended that prohibition of use of the service charge as part of the base for computing the compensation of registered representatives under their contracts with the various member firms constituted price fixing which was a *per se* violation of § 1 of the Sherman Act. Defendants contended, *inter alia*, that the prohibition was within the antitrust immunity which a district judge had recognized in *Gordon* with respect to minimum commission rates, 366 F. Supp. 1261, 1264 (S.D.N.Y. 1973). As we read Judge Ward's opinion, he rejected both contentions. Although agreeing "in principle" that "collective employer action to regulate employee compensation, outside the context of a collective bargaining situation would constitute price fixing,"[4] 377 F. Supp. at 95, the judge thought this was not a case for *per se* liability, but rather one for applying the rule of reason. He continued, *id.* at 97:

> Applying the standards of the rule of reason, the Court finds that defendants' action was not taken with any anticompetitive purpose, nor did it have the effect of restricting competition for the services of registered representatives. Moreover, to restrict passing along the revenues directly was consistent with the purpose for which the service charge was effected, namely, to provide essential immediate assistance to rapidly failing brokerage firms. This purpose is well within the recognized aim of the securities laws, protection of investors and smooth and fair administration of the securities markets.

4 Judge Mansfield had previously denied a motion to dismiss the complaint on the basis of the labor exemption in § 6 of the Clayton Act, 15 U.S.C. § 17, *Cordova* v. *Bache & Co.*, 321 F. Supp. 600 (S.D.N.Y. 1970).

The court then concluded that defendants had not violated the antitrust laws and dismissed the complaint.

II.

In light of the decision in *Gordon,* defendants' claim to antitrust immunity can be restated, borrowing from the Court's language, as follows: "The Securities Exchange Act was intended by the Congress to leave the supervision of the fixing of reasonable rates of commission to the SEC." Interposition of the antitrust laws in such a way as to make the rule governing the distribution of the special service charge a *per se* violation despite the SEC's letter of non-objection "would preclude and prevent the operation of the Exchange Act as intended by Congress and as effectuated through SEC regulatory activity." Implied repeal of the antitrust laws and consequent immunity from liability for imposing the charge is thus, in the words of *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 357 (1963), "necessary to make the Securities Exchange Act work." When the SEC issued its initial letter of non-objection, it was on notice that the constitution and the rules of NYSE, which had been filed with it pursuant to § 6(a)(3) of the Act, 15 U.S.C. § 78f(a)(3), prohibited use of the service charge as a base for the computation of compensation for registered representatives. Before the letter of non-objection to the indefinite extension of the special service charge, the SEC had been expressly alerted to this by the May 19, 1970 telegram from the Association of Investment Brokers.[5] Yet the SEC took no action, as it could have done under § 19(b)(9) of the Securities Exchange Act, 15 U.S.C. § 78(s)(b)(9)

5 A staff memorandum dated August 20, 1970 indicates awareness that most member firms had made no change in the manner of salesmen's compensation. SEC, Memorandum Re Extension of NYSE Commission Surcharge 11-12 (1970).





to request NYSE to modify its Rule 347(e) to include the service charge.[6]

While there is force in the argument, there are several difficulties. It is rather strong medicine to seek to spell out SEC sanction of the enforced omission of the service charge as a basis on which the compensation of registered representatives could be computed under employment agreements when the SEC consistently attempted to stay out of the controversy. More importantly, whereas § 19(b) includes "the fixing of reasonable rates of commission, interest, listing, and other charges" among the illustrations of the sort of matters on which the SEC can request changes in the rules and practices of exchanges, salary arrangements are not specifically included. It would hardly be suggested that if NYSE prescribed a uniform method by which all member firms must compensate registered representatives, or even if it were only to set maximum compensation provisions, and filed rules embodying this with the SEC, that body could grant complete antitrust immunity. Immunizing such an agreement from the antitrust laws would not be "necessary to make the Securities Exchange Act work," *Silver, supra,* at 357; to the contrary, it "would defeat the congressional policy reflected in the antitrust laws without serving the policy of the Securities Exchange Act," *id.* at 360. Even regulatory agencies with express power to grant antitrust immunity have not been authorized to do this in respect of agreements with employees.

As we read *Gordon,* there were two decisive factors that led the Court to find an absolute antitrust immunity. First, the power to fix minimum commission rates had clearly

6 The SEC's failure to take such action may have afforded the Association an opportunity for judicial review. See *Independent Broker-Dealers' Trade Ass'n* v. *SEC,* 442 F.2d 132, 136-43 (D.C. Cir.), *cert. denied,* 404 U.S. 828 (1971).

been delegated to NYSE, as shown by the legislative history of the Securities Exchange Act and by § 19(b). —— U.S. at ——, 43 U.S.L.W. at 4960. Second, the SEC had actively asserted its jurisdiction to review these rates; judicial enforcement of the antitrust laws thus raised the possibility of subjecting the Exchange to different, and perhaps conflicting, standards. *Id.* at ——, 43 U.S.L.W. at 4967. Here, by contrast, the Exchange's authority to enforce the rule in dispute existed only at the periphery of its jurisdiction, and the SEC disclaimed the exercise of any power of review. We thus see no reason to find a complete immunity from the antitrust laws in this case.

However, the failure of defendants' claim for complete antitrust immunity does not mean that plaintiffs are entitled to prevail. Here we find it useful to return to the analysis in *Silver*. The Court was there dealing with "collective action of the Exchange and its members" which "had it occurred in a context free from other federal regulation" would "constitute a per se violation of § 1 of the Sherman Act," as a group boycott, 373 U.S. at 347. The Court seemingly held that regulation of the conduct at issue was not within the Commission's jurisdiction. Yet the Court did not leap from these two propositions to a conclusion that antitrust liability existed. Instead it said, in a passage of such critical importance here, 373 U.S. at 360-61, that we must quote it at length:

> Yet it is only frank to acknowledge that the absence of power in the Commission to review particular exchange exercises of self-regulation does create problems for the Exchange. The entire public policy of self-regulation, beginning with the idea that the Exchange may set up barriers to membership, contemplates that the Exchange will engage in restraints of trade which might well be unreasonable absent



> sanction by the Securities Exchange Act. Without the oversight of the Commission to elaborate from time to time on the propriety of various acts of self-regulation, the Exchange is left without guidance and without warning as to what regulative action would be viewed as excessive by an antitrust court . . . . But, under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act. See *United States* v. *Terminal R. Assn. of St. Louis*, 224 U.S. 383, 394-95; *Board of Trade of the City of Chicago* v. *United States*, 246 U.S. 231, 238. Although, as we have seen, the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws, compare Hale and Hale, Competition or Control VI: Application of Antitrust Laws to Regulated Industries, 111 U. of Pa. L. Rev. 46, 48, 57-59 (1962), it is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim.

This seems to us to mean that within the area of supervised self-regulation contemplated by the Securities Exchange Act, *per se* concepts are generally displaced and the courts are to examine whether the particular restraint, even though it would be a *per se* violation if performed by others, was reasonable. See V Loss, Securities Regulation 3157-62 (1969); Note, *Trade Association Exclusionary Practices: An Affirmative Role For the Rule of Reason*, 66 Col. L. Rev. 1486, 1497-99 (1966). The Court found liability in *Silver* not because the challenged conduct was a group boycott but because the failure to provide the

plaintiffs with any opportunity for a hearing before they were deprived of their private wire services was unfair and served no policy of the Securities Exchange Act, 373 U.S. at 361. The departure from *per se* concepts was emphasized by the Court's statement that one of the virtues of providing an opportunity for a hearing would be to "contribute to the effective functioning of the antitrust court" and "allow the antitrust court to perform its function effectively," 373 U.S. at 362-63. If the conduct alleged in Silver's complaint were to be treated as the *per se* violation that it would have been apart from the effect of the Securities Exchange Act, the antitrust court would not have needed any such assistance.

This analysis is strengthened by an examination of the policies that do support *per se* rules of liability in appropriate antitrust cases. *Per se* standards can be justified on three grounds: They are more certain than the rule of reason; they obviate the need for elaborate and often fruitless evidentiary inquiries; and they reflect an awareness that a court is not the best forum for making complex economic judgments. *United States* v. *Topco Associates,* 405 U.S. 596, 607, 609-10 (1972); *Northern Pacific R.R.* v. *United States,* 356 U.S. 1, 5 (1958). None of these policies has great force in relation to rules of securities exchanges which are "germane" to performance of the duty of self-regulation, *Silver, supra,* 373 U.S. at 356, and are under constant SEC oversight. Rather the rule of reason provides the "breathing space" necessary for the process of supervised self-regulation to work.

The questions therefore are whether the rule prohibiting an automatic pass-through of a portion of the service charge to registered representatives was thus "germane" rather than being "wholly foreign to the purpose of the Securities Exchange Act," 373 U.S. at 362, and, if the former, whether the rule was consistent with reason. Plaintiffs had the burden of showing that these somewhat related questions should be answered in the negative and they did not meet it. The service charges antecedent to that imposed by Rule 383 had been for services not reflecting sales activities; they were for such matters as custodian services, cutting of coupons, collection of dividends, making of transfers, furnishing transcripts of statements, etc. It was not unreasonable for NYSE to provide that all such charges, which represented a return for the services of many people other than salesmen and for costly facilities, should be retained in full by the member, when there was otherwise complete flexibility with respect to compensation arrangements. Plaintiffs contend that the "service charge" imposed by Rule 383 stands differently, since it relates to a purchase or sale, resembles an added commission, and would have been imposed as such except that this would have required an amendment to NYSE's constitution rather than a new rule. However, this is too superficial a view. A substantial justification for the service charge was that back office costs for a small transaction were almost as great as for a large one and were not being adequately compensated by the flat rate commission structure. Moreover, the service charge had been imposed to meet a financial emergency confronting member firms; if it were treated as a commission, on which registered representatives compensated on a commission basis would automatically receive a percentage,[7] the charge would have had to be correspondingly higher to serve its purpose. Any firm which wished to augment the compensation of a registered representative after imposition of the service charge was free to do this by stepping up his base salary, by in-



7 The evidence showed that most of the defendant firms returned in the neighborhood of one-third of the overall commission to their registered representatives, although some representatives apparently received as much as one-half.

creasing his commission rate, or by both. The district court found, 377 F. Supp. at 96:

> The rule prohibiting sharing the service charge with registered representatives was designed primarily to enable member firms to retain needed revenue, furthering the purpose which prompted imposition of the service charge, rather than to achieve any uniformity or reduction in the compensation of registered representatives. The effect of the requirement may have been in part that the registered representatives received, in general, less money than they would have absent the prohibition, although this has not been conclusively demonstrated. There was no stabilizing effect on wages, however, and no greater degree of uniformity in the compensation of registered representatives after the service charge was imposed than before. Competition continued unabated, and in at least one case a firm's increased revenue was reflected in an increase in the registered representatives' commission rate. (Footnote deleted.)

Our review of the record convinces us that these findings were not clearly erroneous.

Given that there was no fixing of compensation of registered representatives in general, we do not find that the limited incursion on compensation arrangements here at issue was unreasonable in light of the conditions member firms faced. Rather, the plaintiffs have placed themselves in much the same position as the United States occupied as plaintiff in *Board of Trade of the City of Chicago* v. *United States*, 246 U.S. 231 (1918). That case concerned a regulation of the Chicago Board of Trade prohibiting members from purchasing grain "to arrive," during the period between the close of what was termed "the Call"





and the opening of the next regular session, at any price other than the closing bid on the Call. The United States proved the existence of the rule, which was price fixing of a sort, and rested. The Court, speaking through Mr. Justice Brandeis, reversed a judgment for the Government and directed dismissal of the bill, holding that the mere existence of the rule was not enough to constitute an antitrust violation, when the effect on competition was slight and the rule served a valuable purpose in the effective working of the Board of Trade. It is true that *Chicago Board of Trade* preceded *United States* v. *Trenton Potteries Co.*, 273 U.S. 392 (1927), which held that a price fixing agreement did not escape antitrust liability simply because the prices were reasonable. But the *Trenton Potteries* opinion did not purport to overrule *Chicago Board of Trade.* Rather it distinguished that case on the following ground, quite pertinent here, 273 U.S. at 401:

> That decision, *dealing as it did with a regulation of a board of trade,* does not sanction a price agreement among competitors in an open market such as is presented here. (Emphasis supplied.)

The judgment dismissing the complaint is affirmed.

# ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the fifth day of August one thousand nine hundred and seventy-five.

Present:

HON. HENRY J. FRIENDLY

HON. WILLIAM H. TIMBERS

HON. MURRAY I. GURFEIN

Circuit Judges,

74-2001

L. JOHN JACOBI and ROBERT GAMBERA, individually, on behalf of the members of the AMERICAN ASSOCIATION OF SECURITIES REPRESENTATIVES, and on behalf of all other securities representatives similarly situated,

Plaintiffs-Appellants,



v.

BACHE & CO., INC., WALSTON & CO., INC.; THOMSON & McKINNON AUCHINCLOSS, INC. (formerly THOMSON & McKINNON, INC.); HORNBLOWER-WEEKS, HEMPHILL, NOYES; LOEB, RHOADES & COMPANY; TUCKER, ANTHONY & R. L. DAY; HARRIS, UPHAM & CO., INC.; DOMINICK INT'L. CORP.; HALLE & STIEGLITZ, INC.; GOODBODY & CO., INC.; BEAR, STEARNS & CO.; LEHMAN BROS.; KIDDER PEABODY & CO., INC.; R.W. PRESSPRICK & CO., INC.; DEAN WITTER & CO., INC.; W.E. HUTTON; REYNOLDS & CO.; PAINE, WEBBER, JACKSON & CURTIS; SCHEINMAN, HOCKSTIN & TROTTA, INC.; PRESSMAN FROLICH & FROST, INC.; NEWBURGER, LOEB & CO.; RAUSHER, PIERCE SECURITIES CORP.; OPPENHEIMER & CO.; STEINER ROUSE & CO., INC.; L. F. ROTHSCHILD & CO.; SPENCER TRASK & CO.; SMITH BARNEY & CO., INC.; and THE NEW YORK STOCK EXCHANGE, INC.,

Defendants-Appellees.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

*Order of the United States Court of Appeals for the Second Circuit*

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed with costs to be taxed against the appellants.

A. DANIEL FUSARO,
Clerk

s/ Edward J. Guardano
Senior Deputy Clerk



**OPINION OF THE UNITED STATES DISTRICT COURT**

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

L. JOHN JACOBI and ROBERT GAMBERA, individually, on behalf of the members of the AMERICAN ASSOCIATION OF SECURITIES REPRESENTATIVES, and on behalf of all other securities representatives similarly situated,

Plaintiffs,

-against-

BACHE & CO., INC., WALSTON & CO., INC.; THOMSON & McKINNON AUCHINCLOSS, INC. (formerly THOMSON & McKINNON, INC.); HORNBLOWER-WEEKS, HEMPHILL, NOYES; LOEB, RHOADES & COMPANY; TUCKER, ANTHONY & R. L. DAY; HARRIS, UPHAM & CO., INC.; DOMINICK INT'L. CORP.; HALLE & STIEGLITZ, INC.; GOODBODY & CO., INC.; BEAR, STEARNS & CO.; LEHMAN BROS.; KIDDER PEABODY & CO., INC.; R.W. PRESSPRICK & CO., INC.; DEAN WITTER & CO., INC.; W.E. HUTTON; REYNOLDS & CO.; PAINE, WEBBER, JACKSON & CURTIS; SCHEINMAN, HOCKSTIN & TROTTA, INC.; PRESSMAN FROLICH & FROST, INC.; NEWBURGER, LOEB & CO.; RAUSHER, PIERCE SECURITIES CORP.; OPPENHEIMER & CO.; STEINER ROUSE & CO., INC.; L. F. ROTHSCHILD & CO.; SPENCER TRASK & CO.; SMITH BARNEY & CO., INC.; and THE NEW YORK STOCK EXCHANGE, INC.,

Defendants.

70 Civ. 3152
R.J.W.

WARD, D.J.

This is an antitrust action brought by two former registered representatives of member organizations of the New York Stock Exchange, Inc. ("the Exchange") against the Exchange and twenty-seven of its member brokerage firms ("the firms"). Plaintiffs claim to represent the class of all registered representatives employed by the firms from April 2, 1970 through July 25, 1971 who were compensated at least in part by commissions on securities transaction which they effected on the Exchange. This was the period of time during which the Exchange required that a "service charge" of $15 or not more than 50% of the commission be added to the commission charged customers for securities transactions involving under 1,000 shares. Exchange policy, reflected in its Constitution and Rules and in its communications to the firms, required the firms to exclude the service charge from the basis upon which they calculated compensation of the registered representatives. Plaintiffs claim that the firms' concurrence with the Exchange in this policy constituted an agreement in restraint of trade in violation of §1 of the Sherman Antitrust Act, 15 U.S.C. §1. They seek treble damages under §4 of the Clayton Act, 15 U.S.C. §15, based upon the difference between their actual compensation during that time period and the amount they would have received had the service charge been included in the basis upon which their commissions were calculated.

For the most part the factual background of this suit is undisputed. During the aforementioned period, member organizations of the Exchange charged commissions for



transactions in securities at minimum rates set forth in Article XV of the Exchange Constitution. In turn, they compensated the registered representatives who actually negotiated the transactions, primarily in the form of commissions which were a percentage of the commissions which the firms charged customers. The firms also customarily compensated their registered representatives by salary, bonuses and incentive payments. The precise systems of compensation varied from firm to firm; the percentages applied for the several types of transactions executed, reliance upon a base salary to be supplemented by commission, and incentive or bonus payments were all variable. Direct comparison of the compensation of registered representatives from firm to firm is thus difficult, but the parties do not dispute that competition was in fact intense.

During late 1969 and early 1970 the firms were experiencing a serious financial crisis, operating at increasing losses, particularly in low volume securities transactions. The minimum commission rate had last been increased in 1958, while costs to the industry had risen by some 60%. The Exchange had retained National Economic Research Associates ("NERA") to conduct studies and to assist in the development of a new commission rate structure, and in February of 1970 presented to the Securities and Exchange Commission ("the Commission") NERA's analysis together with its recommendation for a new rate structure. The commission's response indicated certain unresolved issues and the need for additional data before approval of the new rates; it appeared that approval of a comprehensive new rate structure would require some time. In the meantime, the increasingly acute financial difficulties of some

member firms threatened their continued operation. Advised by NERA, the Exchange recommended that the Commission approve an immediate interim charge, to be called a service charge, in the amount of $15 per transaction but not more than 50% of the commission, to be applied to transactions of under 1,000 shares. According to the Exchange Constitution the Board of Governors could impose such a charge immediately by rule; to levy an equivalent charge by changing the commission rate required an amendment to the Exchange Constitution, which would take six to eight weeks to effect. The Commission, the Exchange, and the firms recognized that this was to be an interim measure, pending the more comprehensive adjustment in the commission rate structure. In mid-March of 1970 the Board of Governors approved in principle the imposition of such a service charge and submitted the proposal to the Commission. On April 2, 1970, the Commission approved the service charge for a period of 90 days, subject to review at the end of that time, and upon the conditions that services to small investors not be curtailed, that the income be used wisely for the improvement of the financial position of the member firms, and that the revenue accrue to the firm effecting the transactions. Accordingly, the Exchange did not include the service charge in the basis upon which it calculated its own charge to the firms, amounting at that time to 1% of the commissions each firm collected.

In addition, in a memorandum to the member firms announcing the imposition of the service charge, the Board of Governors of the Exchange called their attention to Article XV of the Exchange Constitution and to Rule 347(a). It stated that the service charge was not to be passed along directly to the



registered representatives as part of their commission. It added, however, that the firms remained free, as always, to compensate their registered representatives according to their own individual policies. Thus, while the service charge could not be passed along directly, in effect the increased revenue could be used at least in part to compensate registered representatives if the firms so chose.

Article XV, §1 of the Exchange Constitution provided:

> No bonus or percentage or portion of a commission, whether such commission be at or above the rates herein established, or any portion of a profit except as may be specifically permitted by the Constitution or a rule adopted by the Board of Governors, shall be given, paid or allowed, directly or indirectly, or as a salary or portion of a salary, to a clerk or person for business sought or procured for any member or allied member of the Exchange or member firm or member corporation.

Article XV, §9, which provided for service charges, contained similar language requiring that they be free of any rebate or commission unless expressly permitted by rule of the Board of Governors.

Rule 347(a) of the Rules of the Board of Governors authorized compensation to registered representatives, in the form of salary, commission, percentage of the profit of the

office, or bonus. It contained no provision for compensation directly based on service charges. Thus, unless the Board of Governors were to amend Rule 347(a), the Constitution forbade directly passing along any of the service charge income to the registered representatives.

The draftsmen of the rules effectuating the service charge at one point contemplated such an amendment to Rule 347(a). A preliminary memorandum, not even officially submitted to the Board of Governors, did contain language to this effect. But the version considered by the Board of Governors on March 18, 1970 did not. Neither party has offered competent testimony concerning the reasons for this change. The Commission itself considered only the later draft, which contained no mention of registered representatives compensation.

At the close of the 90-day period the Commission held public hearings to review the service charge, and conditioned its continuing approval upon additional requirements. For example, it required the Exchange and member firms to treat the service charge as part of commission income for purposes of calculating "regular-way reciprocity" with non-member brokerage firms. The registered representatives had objected to the Exchange's rule prohibiting sharing of the service charge with them. The Commission replied by disclaiming any responsibility to intervene in firms' policies concerning compensation to registered representatives, unless a showing were made that such intervention was necessary for the protection of investors. The Commission then approved indefinite continuance of the service charge, reserving the right to rescind its approval at any time that should appear necessary.



The service charge remained in effect until March 24, 1972, when it was replaced by a revised commission rate schedule. During that time none of the member firms included the service charge in the base commission upon which they calculated the compensation due their registered representatives. Compensation practices of member firms continued to vary widely, and competition for the services of the registered representatives continued unabated. The firms retained the service charge as part of their operating revenue, and the Exchange continued to monitor the effect of the increased revenues upon their profits. The Exchange judged that while to some extent the erosion of capital and the heavy losses which had prompted the charge had been stemmed, a significant number of firms continued to sustain losses on transactions of under 1,000 shares.

The registered representatives do not contend that the service charge was unnecessary, nor dispute the importance of enacting it quickly. Their claim is that since no additional services were in fact performed, in substance it was a commission rate increase, and should have been considered such for purposes of their compensation. The Exchange's deliberate policy of excluding the service charge from the basis upon which their compensation was calculated, in which the member firms concurred by adhering to the Constitution and Rules of the Exchange, is, plaintiffs claim, a violation of the antitrust laws.

Defendants, on cross-motions for summary judgment prior to trial, contended that the Securities and Exchange Commission had exclusive or primary jurisdiction over this

matter, and that the antitrust court was therefore without jurisdiction to decide it. For the reasons which follow, this Court rejected defendants' contention, and set the matter down for a prompt trial on the merits.

In *Silver v. New York Stock Exchange,* 373 U.S. 341 (1963), the Supreme Court first enunciated the principles underlying the Exchange's antitrust liability, which have been further developed in a series of subsequent lower court decisions. *Silver* involved a non-member broker whose private wire connections with certain member firms the Exchange had unilaterally ordered disconnected, without notice or hearing. The Court observed that absent the regulatory provisions of the Securities Exchange Act of 1934 ("the Exchange Act"), 15 U.S.C. §78a *et seq.,* the Exchange's action would have constituted a *per se* violation of the antitrust laws. It also noted that the Exchange Act provided no administrative review of the Exchange's action in this instance, and that therefore the antitrust court was the sole forum in which it could be judged. The Court then articulated the standards which govern the Exchange's antitrust liability. It stated that the securities laws do not provide the Exchange with blanket antitrust immunity, but rather act as an implied repealer of the antitrust laws only to the limited extent necessary to make the securities laws work. The Court saw its task as the reconciliation of the "antitrust aim of eliminating restraints on competition with the effective operation of a public policy contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." *Silver,* 373 U.S. at 349.



The Court extensively reviewed the self-regulatory purposes and functions of the Exchange, as well as the supervisory role of the Commission. Briefly stated, those functions are the protection of investors, including safeguarding the financial responsibility of member firms, and insuring fair dealing in securities traded in upon the Exchange. Exchange Act §§6, 19; 15 U.S.C. §§78f, s. But the Court did not determine whether the Commission itself would have primary or exclusive jurisdiction over such questions if the Exchange's action were subject to direct Commission review.

*Thill Securities Corporation v. New York Stock Exchange,* 433 F.2d 264 (7th Cir. 1970), *cert. den.,* 401 U.S. 994 (1971), addressed this question. In that case, plaintiff, a non-member firm, attacked the Exchange's anti-rebate rule, adopted under its self-regulatory authority and subject to review by the Commission. The Court of Appeals reversed the District Court's grant of summary judgment for the Exchange, which had been based on precisely this review jurisdiction of the Commission. It stated that there was no evidence that the Commission was exercising actual and adequate review jurisdiction over the complained-of rule. Even if it were, the Court stated, acknowledging that the Commission may properly and does in fact consider antitrust principles in exercising its review power, the Commission is not the primary body charged with enforcement of the antitrust laws. Rather, the courts are the primary repository of antitrust expertise, and primarily responsible to enforce principles of competition. The Court of Appeals remanded for factual findings concerning the importance of the rule in making the securities laws work, and

its anticompetitive effect. It repeated the standard enunciated in *Silver,* that the task of the Court was to give effect to antitrust principles except insofar as they are necessarily modified in order to fulfill the purposes of the securities laws. In addition, it expressed serious reservations concerning the extent to which the anti-rebate rule could be considered necessary to make the securities laws work.

More recently, in this district, Judge Lasker expressly differed with the analysis of *Thill* in some respects, although he did distinguish the facts of the two cases. *Gordon v. New York Stock Exchange,* 366 F. Supp. 1261 (S.D.N.Y. 1973), *appeal docketed* No. 74-1043, 2d Cir. Dec. 6, 1973, involved a challenge to *inter alia* the commission rate structure of the Exchange. Judge Lasker found that since the Exchange Act explicitly authorized the Exchange to fix reasonable rates of commission which are in fact actively reviewed by the Commission, the Court lacked jurisdiction over an antitrust suit against this practice. He stated:

> We believe that while *Silver* quite properly punctured the umbrella of anti-trust immunity claimed by the Exchange, it did not intend Congress' unique self-regulatory scheme to be totally dampened by the continuous interference of an anti-trust court. We read *Silver* as holding that certain limited areas of Exchange regulation — such as potentially anti-competitive and arbitrary conduct directed at non-members — are properly interfered with by a reviewing court



> since the Act purports to regulate only the conduct of registered exchanges (and their members) with regard to the public, rather than the entire securities business. But *Silver* also contemplates a certain zone of anti-trust immunity in the regulatory process where there is little threat of such arbitrary and discriminatory activity. 366 F. Supp. at 1264.

But distinguishing *Thill,* the Court continued:

> First the Act contains no specific directive to the SEC to supervise member-non-member relations; second, there was before the court no record of active SEC supervision in the area; third, the court thought the power to refuse to share commissions with non-members was a "weapon 'that can be used to injure a particular competitor'" (p. 270) and the plaintiff had alleged that the anti-rebate rule had in fact been unevenly applied.
>
> * * *
>
> We must add, if it is not already clear, that if *Thill* is to be read as holding that an anti-trust court has concurrent jurisdiction with the SEC over all potentially anti-competitive practices and rules, we disagree. 366 F. Supp. at 1267.

Thus, there emerges the applicable rule concerning not only the jurisdiction of this Court, but also the nature of the analysis required in assessing antitrust liability of the Exchange and its members. Where the concededly self-regulatory rule or practice complained of is within the explicit mandate of the Exchange Act and also is actively reviewed by the Commission, that body may and appropriately should itself consider the policies of both the antitrust and the securities laws. But, where the Act contains no explicit directive to the Commission to supervise the practice or rule, the antitrust court may properly consider it. In so doing, it must evaluate both the policies against restraint of competition and the policies of investor protection and fair dealing in securities.

The case presently before this Court in fact overlaps these two spheres.

The service charge itself was a matter over which the Commission possessed and exercised direct regulatory and supervisory authority under 15 U.S.C. §78s(b). The rule concerning compensation to registered representatives, however, fell only partially within the regulatory function of the Commission. *See, Merrill Lynch, Pierce, Fenner & Smith v. Ware,* 414 U.S. 117 (1973). The Commission itself, when the registered representatives protested the rule's effect, declined to intervene in matters affecting the relationship between the member firms and their employees, unless the latter could demonstrate a particular need for intervention for the protection of investors. Instead, the registered representatives have chosen to attack the rule on the ground that it violates the antitrust



laws. In view of the Commission's disclaimer of primary responsibility over that aspect of the rule which the registered representatives here contest, and since the focus of the challenge here is in the sphere of the courts' particular antitrust competence, the Court exercises its concurrent jurisdiction over the controversy.

In this connection, we need only briefly consider defendants' claim of total antitrust exemption since acts pursuant to the Exchange's Constitution and Rules constitute its exercise of self-regulatory authority, and, under §19b of the Exchange Act, are the equivalent of government action. *Silver,* as noted above, established that even such self-regulatory activity is not wholly immune from antitrust attack. Rather the nature of the scrutiny, whether by the Commission or the antitrust court, is altered. It is evident that self-regulatory actions taken by the Exchange may go beyond the mandate of §19b of the Exchange Act. The analysis required by *Silver* is an application of traditional antitrust principles of liability, except insofar as the action of the Exchange in the exercise of self-regulatory authority is found to be explicitly required by the Act or necessary to effectuate its purposes.

In order to recover in a private antitrust action under §4 of the Clayton Act, 15 U.S.C. §15, plaintiffs must establish a causal connection between the alleged antitrust violation and some injury to them. This fact of legal injury must be established with certainty, although at this stage the precise amount of damages may remain somewhat speculative. *See, Billy Baxter, Inc. v. Coca-Cola Co.,* 431 F.2d 183 (2d Cir. 1970), *cert. denied,* 401

U.S. 923 (1971); *Fields Production, Inc. v. United Artists Corp.*, 318 F. Supp. 87 (S.D.N.Y. 1969), *aff'd per curiam*, 432 F.2d 1010 (2d Cir. 1970), *cert. denied*, 401 U.S. 949 (1971); *Productive Inventions, Inc. v. Trico Products Corp.*, 224 F.2d 678 (2d Cir. 1955), *cert. denied*, 350 U.S. 936 (1956).

Defendants contend that plaintiffs have not and cannot establish with certainty any financial loss arising from defendants' actions. They point out that the member firms at all times remained free to negotiate not only the registered representatives' rates of commission, but also all other elements of their compensation, including salary, incentive payments, and bonuses. Thus, it cannot be said with certainty either that the increased revenue was not in fact in some way reflected in the registered representatives' compensations, or conversely, that had the service charge been included in the basis upon which the registered representatives' commissions were calculated, their rates of commission would have remained constant and their actual compensation accordingly increased. Because of these uncertainties, defendants maintain, plaintiffs cannot claim to have been injured as a direct result of defendants' actions.

These considerations, however, are more relevant to calculations of the amount of damages should liability be found. Plaintiffs have shown that had the additional revenue been obtained by way of a commission rate increase rather than a service charge, or had Rule 347(a) been amended to permit passing it along to them, they would have been entitled to share in this increased revenue directly. Because of defendants' actions they were not so entitled. They have therefore demostrated



sufficient legal injury causally related to the actions of defendants to permit further consideration of their claims.

Plaintiffs contend that defendants' action in refusing to pass along the service charge is a horizontal agreement analogous to price fixing and as such is illegal *per se* under the antitrust laws. They further contend that since the service charge was enacted in alleged violation of the Constitution of the Exchange, it cannot fall within the rules of *Silver* and *Thill, supra,* that actions taken by the Exchange pursuant to its authority to make rules, under §6 of the Exchange Act, 15 U.S.C. §78f, are not illegal *per se* under the antitrust laws, but rather must be examined to determine whether they are exempt from the application of the antitrust laws because necessary to make the Act work. Two interlocking questions are thus presented.

First is the question whether the manner in which the service charge was adopted precludes application of the particular analysis mandated by *Silver, supra,* for cases involving a conflict between the securities laws and the antitrust laws. If not, the Court will consider the policies of the securities laws as well as of the antitrust laws in determining liability. The second question is whether under a strict antitrust analysis, prior to any consideration of harmony with the securities laws, the action taken by defendants can be considered a *per se* violation. If it is not, then the Court must look to its purpose and its anticompetitive effect before judging it violative of the antitrust laws, *see, e.g., Chicago Board of Trade v. United States,* 246 U.S. 231 (1918), rather than confining itself solely to a consideration of whether it was necessary to effectuate the policies of the Exchange Act.

In evaluating whether the rule of *Silver* applies, it is essential to focus first on the Constitution and Rules of the Exchange. As described above, its Constitution in Article XV, §1, forbids the sharing of *any* commission levied by the firms upon securities transactions with any employee, as commission, salary or bonus, except in accordance with the Constitution or the Rules of the Board of Governors. Article XV, §9, contains a similar provision with respect to service charges. At the time that the service charge was imposed, the Rules of the Board of Governors provided that the registered representatives could be compensated on a commission or salary basis or by bonus, but did not directly provide for sharing of the service charge revenue. Yet the Board of Governors possessed full authority to amend Rule 347(a) to allow passing along a percentage of the service charge. Conversely, had the charge to obtain additional revenue been imposed by Constitutional amendment, the Board of Governors was fully authorized to forbid, by rule, its inclusion in the basis upon which the commissions of registered representatives were calculated. The evidence introduced at trial showed that the reason for enacting the service charge by way of rule rather than constitutional amendment was the undisputed immediacy of the need for added revenues. Under these circumstances, this Court cannot accept plaintiffs' contention that, as the service charge was in effect a commission increase by another name, this technical irregularity in nomenclature means that the action was not taken in compliance with the requirements of the Exchange Act and therefore must be judged exclusively by the application of antitrust principles.

Therefore, the analysis of *Silver* applies. The task of this Court is to reconcile the conflicting policies of the antitrust and



securities laws, giving effect to antitrust principles except insofar as necessary to make the securities acts work.

Plaintiffs next argue that for the Exchange, joined by the firms, to prohibit the direct passing along of a portion of the service charge revenues to the registered representatives constitutes collective employer action to regulate the wages of employees, a horizontal restraint analogous to price fixing, and as such, plaintiffs contend, a *per se* violation of the antitrust laws.

At trial plaintiffs did not contest the Exchange's authority pursuant to §6 and §19 of the Exchange Act, generally to make rules concerning the use of commissions charged by member firms to compensate registered representatives. Nor did they then claim that the Exchange's usual exercise of this authority constitutes impermissible price fixing or offer any evidence which so suggested. Plaintiffs at trial simply challenged one particular instance of the Exchange's exercise of its rule making authority, as clearly restrictive of their compensation.[1] Yet, in their proposed conclusions of law, submitted after trial, plaintiffs did request this Court to find Article XV, §§1 and 9, and Rule 347(a), unlawful *per se* insofar as they restrict the compensation which the member firms may pay to their registered representatives.

We will consider their arguments first in reference to these provisions as they affected the service charge, and then evaluate them generally.

1. One explanation offered for singling out this instance, that on this occasion the Exchange operated in violation of its own Constitution, as discussed above, is unpersuasive.

In support of their claim, plaintiffs argue first that all horizontal agreements in restraint of trade are illegal *per se;* second, that in particular, collective employer action to regulate wages is equivalent to price fixing and *a fortiori* illegal *per se;* and third, that under the cases even indirect or partial price fixing is governed by this *per se* rule.

Plaintiffs cite *United States v. Topco Associates, Inc.,* 405 U.S. 596 (1972), for the general proposition that all horizontal agreements in restraint of trade are illegal *per se* under the antitrust laws. That case, however, dealt specifically with horizontal agreements to divide territory, and held, for the first time, that all horizontal territorial restrictions violate the antitrust laws without proof of purpose or effect. It based this conclusion on a line of cases all dealing with such territorial restrictions. The case cannot be extended to mandate barring all horizontal agreements of whatever kind or however minimal anticompetitive impact. Indeed, the rule of reason has often been held applicable to horizontal agreements. *See, e.g., Standard Oil Co. of New Jersey v. United States,* 221 U.S. 1 (1911); *United States v. American Tobacco Co.,* 221 U.S. 106 (1911); *Chicago Board of Trade, supra.*

In direct support of the analogy between defendants' action here and price fixing, plaintiffs have cited only Judge Mansfield's decision denying a motion to dismiss an earlier complaint in this case *(Cordova v. Bache & Co.,* 321 F. Supp. 600 (S.D.N.Y. 1970)), and research fails to disclose another. In principle this Court agrees that collective employer action to regulate employee compensation, outside the context of a



collective bargaining situation, would constitute price fixing. But it does not follow, as plaintiffs argue, that the Exchange's regulation of the single element of compensation at issue here, in the context surrounding the imposition of the service charge, was a scheme to fix or stabilize prices.

Plaintiffs reason from cases dealing with price fixing, and maintain that fixing any one element of a price is always illegal. In fact, the rule is not quite so simple. When the purpose of an agreement is to fix or stabilize prices, even if the means used affects only one element of the price structure, or only indirectly affects prices, the agreement is illegal *per se,* without regard to the power of the conspirators in fact to fix prices, or the anticompetitive effects of the scheme, or its economic justification. Thus, distribution systems with the purpose of controlling resale price are illegal, as are fixing maximum or minimum prices, or attempting to build a floor under prices by systematic spot purchases. *See, e.g., United States v. Socony-Vacuum Oil Co., Inc.,* 310 U.S. 150 (1940); *United States v. Bausch & Lomb Optical Co.,* 321 U.S. 707 (1944); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.,* 340 U.S. 211 (1951). But where an arrangement is not on its face a price fixing scheme in purpose, the courts do not apply a *per se* prohibition, looking instead to whether those making the arrangement possess the power or intent to fix prices, and whether prices are actually stabilized to determine whether the behavior in fact amounts to price fixing. *Report of the Attorney General's National Committee to Study the Antitrust Laws,* 1955, p. 14. Arrangements to exchange marketing information fall into this category, as did a restriction on the period of price making in

one segment of trading in one commodity in *Chicago Board of Trade. See, e.g., American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921); *United States v. American Linseed Oil Co.*, 262 U.S. 371 (1923); *Maple Flooring Mfrs. Ass'n. v. United States*, 268 U.S. 563 (1925); *Cement Mfrs. Protective Ass'n. v. United States*, 268 U.S. 588 (1925); *Chicago Board of Trade, supra.* If after such examination the court determines that the arrangement is price fixing it is illegal *per se, e.g., American Column & Lumber Co., supra,* if it is not, the traditional rule of reason applies, and the conduct is illegal only if anticompetitive in purpose or effect. *E.g., Maple Flooring Mfrs. Ass'n., supra; Chicago Board of Trade, supra.*

The action plaintiffs contest in this case resembles the latter type of arrangement. While the rule making power of the Board of Governors may give the Exchange and its members the power to stabilize the compensation of registered representatives, this was clearly not the expressed purpose of the service charge. And the rule prohibiting sharing the service charge with registered representatives was designed primarily to enable member firms to retain needed revenue, furthering the purpose which prompted imposition of the service charge, rather than to achieve any uniformity or reduction in the compensation of registered representatives. The effect of the requirement may have been in part that the registered representatives received, in general, less money than they would have absent the prohibition, although this has not been conclusively demonstrated. There was no stabilizing effect on wages, however, and no greater degree of uniformity in the compensation of registered representatives after the service charge was imposed than before. Competition



continued unabated, and in at least one case a firm's increased revenue was reflected in an increase in the registered representatives' commission rate.[2] Under these circumstances, this Court does not consider this an arrangement for the purpose of fixing prices. The traditional rule of reason therefore applies. Nor, applying this rule, does this Court find the Exchange's action anticompetitive in purpose or effect.

The same reasoning applies with still more force to the Exchange's general regulation of registered representatives' compensation, through the guidelines set forth in Article XV, §§1 and 9, of its Constitution and Rule 347(a). As plaintiffs' own exhibits reveal, the Exchange does not attempt to regulate the exact compensation of the registered representatives in any way, but within very broad guidelines set forth in its Constitution and Rules, allows the firms to establish their own systems of compensation as well as their rates. These broad guidelines have not been used, and it is difficult to imagine how, in their present form, they might be used, to achieve conformity in wages or to reduce competition for the services of registered representatives. This Court does not find either the guidelines or their usual application to constitute an arrangement to fix prices or affect competition.

As noted above, the decisions in *Silver* and *Thill, supra,* require that antitrust liability of the Exchange and its member firms for actions taken pursuant to the Exchange Act, be judged only after appropriate consideration of the policies of the

2. The complaint against that firm, Shearson, Hamill & Co., Inc., was dismissed during the trial.

securities laws. *See also* Chief Justice Warren's dissent from the denial of certiorari in *Kaplan v. Lehman Bros.*, 389 U.S. 954 (1967). The securities laws are designed to regulate and to some extent stabilize the securities market to ensure protection of investors and fair dealing in securities. First among the Exchange Act's enumeration of matters concerning which the Commission may properly review, alter and supplement the Exchange rules is "(1) safeguards in respect of the financial responsibility of members. . . ." 15 U.S.C. §78s(b).

In this case, the service charge was approved after actual Commission scrutiny. The Commission judged it necessary for the protection of investors that immediate interim measures be taken to supply additional revenue to rapidly failing brokerage firms. In this sense, the service charge itself was necessary to make the securities laws work. Moreover, to insure that the additional charge to investors was in fact used to further the end for which it was enacted, the Commission formally required that the revenue so generated be retained by the firms effecting the transactions and be used prudently to achieve financial stability. While the Commission did not formally require that the service charge be excluded from the formulae for compensating registered representatives, and indeed, when the latter objected to the exclusion informed them that this was a matter in which it would not intervene, it is entirely consistent with the purpose for which the charge was levied, that it be so excluded. The revenue was thereby retained at the level judged most crucial, and individual firms remained free to decide for themselves whether to increase the salaries of their employees. In fact, the evidence at trial showed that the revenue generated by the service charge



was insufficient to keep the firms from operating at a loss, but at best, merely stemmed the continued erosion of capital and relieved the most acute financial pressure on some of the firms. Thus, the limitations the Exchange imposed themselves furthered the purposes of the securities laws.

In summary, defendants' action in imposing the service charge and prohibiting its direct use in calculating the compensation due registered representatives was not a price fixing scheme or any other *per se* violation of the antitrust laws. Applying the standards of the rule of reason, the Court finds that defendants' action was not taken with any anticompetitive purpose, nor did it have the effect of restricting competition for the services of registered representatives. Moreover, to restrict passing along the revenues directly was consistent with the purpose for which the service charge was effected, namely, to provide essential immediate assistance to rapidly failing brokerage firms. This purpose is well within the recognized aim of the securities laws, protection of investors and smooth and fair administration of the securities markets. Therefore, in the judgment of this Court, defendants have committed no violation of the antitrust laws as charged by plaintiffs.

Plaintiffs also alleged violations of §340 of the New York General Business Law and of the common law of the states in which the Exchange and member firms do business. However, plaintiffs offered no proof at trial on these claims and appear to have abandoned them.

Accordingly, the plaintiffs' second amended complaint is dismissed. The foregoing constitutes the findings of fact and

conclusions of law of the Court for the purposes of Rule 52, Fed. R. Civ. P.

Settle judgment on notice.

Dated: June 3, 1974

s/ Robert J. Ward
U. S. D. J.



## SECTION 1 OF THE SHERMAN ACT, 15 U.S.C. §1

**Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal: *Provided,* That nothing contained in sections 1 to 7 of this title shall render illegal, contracts or agreements prescribing minimum prices for the resale of a commodity which bears, or the label or container of which bears, the trademark, brand, or name of the producer or distributor of such commodity and which is in free and open competition with commodities of the same general class produced or distributed by others, when contracts or agreements of that description are lawful as applied to intrastate transactions, under any statute, law, or public policy now or hereafter in effect in any State, Territory, or the District of Columbia in which such resale is to be made, or to which the commodity is to be transported for such resale, and the making of such contracts or agreements shall not be an unfair method of competition under section 45 of this title: *Provided further,* That the preceding proviso shall not make lawful any contract or agreement, providing for the establishment or maintenance of minimum resale prices on any commodity herein involved, between manufacturers, or between producers, or between wholesalers, or between brokers, or between factors, or between retailers, or between persons, firms, or corporations in competition with each other. Every person who shall make any contract or engage in any combination or conspiracy declared by sections 1 to 7 of this title to be illegal shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.**

**July 2, 1890, c. 647, §1, 26 Stat. 209; Aug. 17, 1937, c. 690, Title VIII, 50 Stat. 693; July 7, 1955, c. 281, 69 Stat. 282.**

IN THE

# Supreme Court of the United States

October Term, 1975

No. 75-660

L. JOHN JACOBI and ROBERT GAMBERA, etc.,
*Petitioners,*
*against*

BACHE & CO., INC., NEW YORK STOCK EXCHANGE, INC., *et al.,*
*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

WILLIAM ELDRED JACKSON
RUSSELL E. BROOKS
MARK L. DAVIDSON
*Attorneys for Respondent*
*New York Stock Exchange, Inc.*
1 Chase Manhattan Plaza
New York, New York 10005

MARVIN SCHWARTZ
*Attorney for Respondents*
*Bache & Co., Inc.; Kidder, Peabody & Co., Inc.; Dean Witter & Co., Inc.; Smith, Barney & Co., Inc.; and Dominick International Corp.*
48 Wall Street
New York, New York 10005

[The Names of the attorneys for all respondents appear at the end of the brief.]

*Of Counsel:*

MILBANK, TWEED, HADLEY & MCCLOY
1 Chase Manhattan Plaza
New York, N. Y. 10005

SULLIVAN & CROMWELL
48 Wall Street
New York, N. Y. 10005

December 3, 1975

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## RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

### Counter-Statement of the Question Presented

Absent immunity, is the question of antitrust liability for securities exchange rules which are within the area of supervised self-regulation mandated by the Securities Exchange Act of 1934 to be determined by the rule of reason or by *per se* concepts?

### Statutory Provisions Involved

In addition to Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1 (Pet. p. 3), there is also involved Sections 6(a)(4) and 19(b) of the Securities Exchange Act of 1934

("the Exchange Act"), 15 U.S.C. §§ 78f(a)(4) and 78s(b),* reading as follows:

"Section 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

* * *

"(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption."

* * *

"Section 19.

* * *

"(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as *(1) safeguards in respect of the financial responsibility of members* and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; *(9) the fixing of reasonable rates of commission, interest, listing, and other charges;* (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters." (Emphasis added)

* All references to the Securities Exchange Act of 1934 are to the Act prior to the amendments accomplished by the Securities Reform Act of 1975, Public Law No. 94-29, signed by the President on June 4, 1975.



## Counter-Statement of the Case

This action was brought by two registered representatives (securities salesmen) against New York Stock Exchange, Inc. (the "Exchange") and 27 of its member organizations on behalf of all such representatives employed by those organizations who, during the period April 2, 1970, through June 25, 1971, were compensated at least in part by sharing in a portion of the fixed minimum commissions required by Exchange rules to be charged on securities transactions effected on the Exchange. (See 46A)*

* "A" refers to the appendix filed in the Court below.

Prior to and during this period, member organizations of the Exchange were in dire financial straits and required additional revenue for survival. (293-307A) Acting pursuant to its Exchange Act obligation to protect investors from the danger of a financially insecure brokerage community (see Sections 6(d) and 19(b) (1), 15 U.S.C. §§ 78f (d) and 78s(b) (1)), the Exchange adopted a new Rule 383, which would impose an interim service charge on Exchange transactions in addition to the minimum commission. (248A-253A) The proposed rule was submitted to the Securities and Exchange Commission (the "SEC") for approval prior to its adoption in accordance with SEC Rule 17a-8 (17 C.F.R. § 240.17a-8). The Exchange advised the SEC that the new rule would be adopted pursuant to Article XV, Section 9, of the Exchange's Constitution, which expressly prohibited the sharing of service charges by member organizations with their employees. (251A-253A)

The Exchange also advised the SEC, as well as its member organizations, that despite the prohibition against sharing of the interim service charge with salesmen, compensation policies remained matters for the individual discretion of member organizations, subject only to the requirement that any increase in compensation not imperil the member organization's financial integrity. (414A) Thus, throughout the period each member organization remained free to increase or decrease salesmen's compensation in whatever way it deemed appropriate.

The prohibition of Article XV, Section 9, was the basis of petitioners' claim. They claimed that the emergency service charge should have been treated as a commission increase and that registered representatives should have been permitted an increase in compensation through sharing in the revenues generated by the service charge.



Article XV, Section 9, was at the time of the adoption of the service charge (and had been for many years) on file with the SEC as was required by Section 6(a)(3) of the Exchange Act, 15 U.S.C. § 78f(a)(3). (251-252A) Both prior to and immediately following the Exchange's submission of Rule 383 to the SEC, extensive discussions took place between the Exchange and the SEC concerning both the necessity for and the impact of the proposed new rule. (259A-261A; 265A-274A) The SEC carefully scrutinized the rule in discharge of its Section 19(b)(1) obligation to safeguard the financial responsibility of brokerage firms doing business on registered exchanges, 15 U.S.C. § 78s(b) (1), and in exercise of its Section 19(b)(9) authority to protect investors by insuring the fixing of reasonable rates of commission and other charges, 15 U.S.C. §78s(b)(9). (259A-261A)

The SEC thereafter approved the proposed rule, but on the following conditions: (a) the Exchange must take steps to assure that all brokerage services were restored to small investors; (b) the Exchange must insure that revenues derived as the result of Rule 383 were prudently employed by member firms "to improve their operations and financial position"; (c) the Exchange must pledge to provide to the SEC continuing financial data on the operation of the service charge so that its effects could be monitored by the SEC; and (d) the service charge would expire in 90 days. (259A-261A; 414A)

Thereafter, the SEC maintained close surveillance over the administration of the service charge. (262A-264A) The data generated by such monitoring, of course, reflected that the service charge revenues were not being used to increase registered representatives' compensation. As a result, the SEC was fully aware that Article XV, Section 9, which was on file with the SEC, prohibited member or-

ganizations from sharing service charge revenues with with their salesmen. (416A)

In addition, the Association of Investment Brokers—petitioners' trade association—requested the SEC to intervene and direct the Exchange to lift its restriction. (322A) This the SEC declined to do, although noting that it would be receptive to evidence demonstrating that an exercise of its Section 19(b) authority over this matter was "necessary or appropriate". (322A) Furthermore, hearings on a proposed extension of the service charge were held by the SEC in July 1970, during which registered representatives appeared and testified, again complaining of the effects of Article XV, Section 9. (416A; 323A-326A) The SEC once more refused either to request or direct the Exchange to alter the rule. (308-326A) Instead, it affirmatively permitted the service charge to continue in effect until March of 1972. (*id.;* Pet. p. 3)

It was only when the SEC rejected the entreaties of petitioners' trade association that petitioners brought this action, claiming that Article XV, Section 9, was tantamount to an agreement among competitors to restrict the compensation of their employees and, thus, price fixing in violation of the antitrust laws.

A trial was had before the District Court. Contrary to the petition (p. 5), the District Court (23-46a)* did not find Rule 383 or Article XV, Section 9, immune from the antitrust laws, despite the uncontested fact that both were adopted pursuant to Section 19(b) of the Exchange Act and subject to SEC review. It held that petitioners had not shown that the claimed restraint was in fact price fixing. The Court found on the evidence that the Exchange's

* "a" refers to the appendix attached to the petition.



rules were designed to preserve the financial integrity of its member organizations and thus to protect their customers, the investing public. On this point the Court found:

> ". . . the service charge was approved after actual Commission scrutiny. The Commission judged it necessary for the protection of investors that immediate interim measures be taken to supply additional revenue to rapidly failing brokerage firms. In this sense, the service charge itself was necessary to make the securities laws work. Moreover, to insure that the additional charge to investors was in fact used to further the end for which it was enacted, the Commission formally required that the revenue so generated be retained by the firms effecting the transactions and be used prudently to achieve financial stability. While the Commission did not formally require that the service charge be excluded from the formulae for compensating registered representatives, and indeed, when the latter objected to the exclusion informed them that this was a matter in which it would not intervene, it is entirely consistent with the purpose for which the charge was levied, that it be so excluded. The revenue was thereby retained at the level judged most crucial, and individual firms remained free to decide for themselves whether to increase the salaries of their employees. In fact, the evidence at trial showed that the revenue generated by the service charge was insufficient to keep the firms from operating at a loss, but at best, merely stemmed the continued erosion of capital and relieved the most acute financial pressure on some of the firms. Thus, the limitations the Exchange imposed themselves furthered the purposes of the securities laws." (44a-45a)

The Court therefore concluded that the rules attacked were not price fixing rules, and that furtherance of customer protection—an Exchange Act objective—outweighed petitioners' claims for salary increases and justified any incidental anticompetitive effect on compensation.

The petition notwithstanding (see pp. 5-6, 9-10), the Court of Appeals (1-19a) did not reverse the District Court and did not premise its affirmance on *Gordon* v. *New York Stock Exchange, Inc.* — U.S. —, 95 S. Ct. 2598 (1975). Rather, the Court affirmed on the authority of this Court's opinions in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963), and *Board of Trade of the City of Chicago* v. *United States,* 246 U.S. 231 (1918), and endorsed the District Court's application of a "rule of reason" approach in assessing the claimed restraint. The Court of Appeals did not affirm merely because it found that petitioners had failed to meet their burden of proof, although that indeed was the case. It also affirmed because the record amply supported the trial court's findings that the challenged rules were "germane" to the performance of the Exchange's mandated duty of self-regulation and, thus, justified as in furtherance of the objectives of the Exchange Act. Those findings were that:

> "The Rule prohibiting sharing the service charge with registered representatives was designed primarily to enable member firms to retain needed revenue, furthering the purpose which prompted imposition of the service charge, rather than to achieve any uniformity or reduction in the compensation of registered representatives. The effect of the requirement may have been in part that the registered representatives received, in general, less money than they would have absent the prohibition, although this has not been conclusively demonstrated. There was no stabilizing effect on wages, however, and no greater degree of uniformity in the compensation of registered representatives after the service charge was imposed than before. Competition continued unabated, and in at least one case a firm's increased revenue was reflected in an increase in the registered representatives' commission rate." (18a) (Footnote omitted.)



## Reasons for Denying the Writ

There is no conflict between the decision below and this Court's decisions in *Gordon* v. *New York Stock Exchange, Inc., supra,* which dealt only with antitrust immunity and did not consider applicability of the rule of reason, or in *Silver* v. *New York Stock Exchange, supra,* which applied the rule of reason to Exchange conduct held not to be immune.

Moreover, the decision below has no effect on other regulated industries since the Exchange Act is unique among federal regulatory statutes in mandating self-regulation by private bodies, the exchanges, subject to review and revision by a government agency, the SEC.

## ARGUMENT

### I

**The decision below follows this Court's decisions in *Silver* and *Chicago Board of Trade* and is not inconsistent with the Court's decision in *Gordon*.**

In *Silver,* the Exchange argued that unless its withdrawal of a non-member's private wire privileges were held immune from the antitrust laws, the fear of antitrust liability would stifle Exchange self-regulatory activity contemplated by the Exchange Act. While concluding that the challenged conduct was not immune because not within the SEC's review power under the Exchange Act, this Court met the Exchange's argument by ruling that non-immune conduct which fell within the scope and purpose of the Exchange Act would be judged under the rule of reason:

> ". . . *under the aegis of the rule of reason,* traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act. . . . Although, as we have seen, the statutory scheme of that Act is not sufficiently pervasive to create a total exemption from the antitrust laws . . . , it is also true that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." (373 U.S. at 360-361) (Emphasis added)

On the facts of *Silver,* the Court found the challenged conduct unjustifiable under the rule of reason. Antitrust liability was held to exist.



The decision below was based on this Court's application in *Silver* of the rule of reason test (14a-20a), together with this Court's decision in *Chicago Board of Trade* (18a-19a), which was in turn cited as a basis for the *Silver* decision. As this Court did in *Silver,* the Court below first sought to determine whether immunity existed. Applying the reasoning of this Court's decision in *Gordon* (13a-14a), the Court of Appeals found immunity absent. The Court then went on, as did this Court in *Silver,* to consider whether the challenged conduct was within the area of supervised self-regulation contemplated by the Exchange Act in which *per se* concepts were displaced by the rule of reason. (15a-16a) The Court of Appeals found (16a-17a) the challenged conduct to be justifiable under the rule of reason on the basis of the findings of the District Court, which the Court of Appeals found to be supported by the record. See *supra,* pp. 8-9.

The decision below in no way conflicts with this Court's decision in *Gordon.* *Gordon* held that the Exchange's rules fixing minimum commission rates were immune from the antitrust laws. The Court accordingly had no reason to consider the rule of reason as the proper standard by which to judge non-immune Exchange self-regulation, as it earlier had done in *Silver.**

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* This Court's rule of reason analysis in Silver has been applied in other lower federal court decisions dealing with Exchange conduct found not to be immune. Thill Securities Corp. v. New York Stock Exchange, 433 F.2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971); Cowen v. New York Stock Exchange, 371 F.2d 661 (2d Cir. 1967); Robert W. Stark, Jr., Inc. v. New York Stock Exchange, Inc. 346 F.Supp. 217 (S.D.N.Y.), *aff'd per curiam,* 466 F.2d 743 (2d Cir. 1972); J. R. Williston & Beane, Inc. v. Haack, 387 F.Supp. 173 (S.D.N.Y. 1974) *See also* United States v. Morgan, 118 F.Supp. 621, 689, 694 (S.D.N.Y. 1953).

## II

**The decision below does not apply to any other regulated industry.**

There is no ground for petitioners' claim that the decision below will create a "no-man's land" in which regulated industries are permitted to engage in "reasonable" price fixing not subject to regulation. (Pet. p. 11) This Court's decision in *Silver,* as well as the decision below, are clear that the rules of antitrust liability applied in both cases are unique to the scheme of self-regulation contemplated by the Exchange Act. It is clear from the quotation from the *Silver* decision relied upon by the Court below that its holding relates only to "particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act [which] may be regarded as justified in answer to the assertion of an antitrust claim." (15a)



## CONCLUSION

**The petition for a writ of certiorari should be denied.**

December 3, 1975

Respectfully submitted,


William Eldred Jackson
Russell E. Brooks
Mark L. Davidson
*Attorneys for Respondent New York Stock Exchange, Inc.*
1 Chase Manhattan Plaza
New York, New York 10005

Marvin Schwartz
*Attorney for Respondents Bache & Co., Inc.; Kidder, Peabody & Co., Inc.; Dean Witter & Co., Inc.; Smith, Barney & Co., Inc.; and Dominick Internationl Corp.*
48 Wall Street
New York, New York 10005

Anthony R. Mansfield
Kenneth J. Kelly
*Attorneys for Respondent Rauscher Pierce Securities Corporation*
63 Wall Street
New York New York 10005

Lindsay A. Lovejoy, Jr.
*Attorney for Respondents Lehman Bros. and Tucker Anthony & R. L. Day*
1 Battery Park Plaza
New York, New York 10004

*Of Counsel:*

Milbank, Tweed, Hadley & McCloy
1 Chase Manhattan Plaza
New York, New York 10005

Sullivan & Cromwell
48 Wall Street
New York, New York 10005

Seward & Kissel
63 Wall Street
New York, New York 10005

Simpson, Thacher & Bartlett
1 Battery Park Plaza
New York, New York 10004

WINTHROP, STIMSON, PUTNAM & ROBERTS
40 Wall Street
New York, New York 10005

STEPHEN A. WIENER
THEODORE WEITZ
*Attorneys for Respondents Bear, Stearns & Co. and R. W. Pressprich & Co., Inc.*
40 Wall Street
New York, New York 10005

GIFFORD, WOODY, CARTER & HAYS
14 Wall Street
New York, New York 10005

L. MIFFLIN HAYS
LOUIS PROYECT
*Attorneys for Respondent Harris, Upham & Co.*
14 Wall Street
New York, New York 10005

E. MICHAEL GROWNEY, JR., Esq.
*Attorney for Respondent Spencer Trask & Co., Incorporated*
60 Broad Street
New York, New York 10005

SHEARMAN & STERLING
53 Wall Street
New York, New York 10005

GEORGE J. WADE
*Attorney for Respondent W. E. Hutton*
53 Wall Street
New York, New York 10005

HALL, MCNICOL, MARRET & HAMILTON
330 Madison Avenue
New York, New York 10017

WILLIAM C. BIELUCH, JR.
*Attorney for Respondent Thomson & McKinnon Auchincloss Inc.*
330 Madison Avenue
New York, New York 10017



BREED, ABBOTT & MORGAN
1 Chase Manhattan Plaza
New York, New York 10005

JOSEPH P. DAILEY
*Attorney for Respondent Walston & Co., Inc.*
1 Chase Manhattan Plaza
New York, New York 10005

NATHAN LEVENTON, Esq.
*Attorney for Respondent Steiner, Rouse & Co., Inc.*
261 Broadway
New York, New York

MOSES & SINGER
51 West 51st Street
New York, New York 10019

DAVID B. EIZENMAN
*Attorney for Respondent L.F. Rothschild & Co.*
51 West 51st Street
New York, New York 10019

SPEAR & HILL
1 State Street Plaza
New York, New York 10004

ELIOT LUMBARD
LAURENCE GROSBERG
*Attorneys for Respondent Reynolds & Co.*
1 State Street Plaza
New York, New York 10004

BRESSLER, MEISLIN & LIPSITZ
90 Broad Street
New York, New York 10004

STEVEN LIPSITZ
*Attorney for Respondent Pressman Frolich & Frost Incorporated*
90 Broad Street
New York, New York 10004

BEEKMAN & BOGUE
5 Hanover Square
New York, New York 10005

MILTON WEISS
*Attorney for Respondents Hornblower & Weeks-Hemphill, Noyes and Paine, Webber, Jackson & Curtis*
5 Hanover Square
New York, New York 10005

Brown, Wood, Fuller,
Caldwell & Ivey
1 Liberty Plaza
New York, New York 10006

Cahill, Gordon & Reindel
80 Pine Street
New York, New York 10005

Fried, Frank, Harris,
Shriver & Jacobson
120 Broadway
New York, New York 10005

Finley, Kumble, Heine,
Underberg & Grutman
477 Madison Avenue
New York, New York 10022

Guggenheimer & Untermyer
80 Pine Street
New York, New York 10005

James B. May
Thomas J. Mullaney
*Attorneys for Respondent*
*Goodbody & Co.*
1 Liberty Plaza
New York, New York 10006

David R. Hyde
George Wailand
*Attorneys for Respondent*
*Loeb, Rhoades & Company*
80 Pine Street
New York, New York 10005

Leslie A. Blau
*Attorney for Respondent*
*Halle & Stieglitz, Inc.*
120 Broadway
New York, New York 10005

Herbert Roth
*Attorney for Respondent*
*Newburger, Loeb & Co.*
477 Madison Avenue
New York, New York 10022

Marvin E. Pollack
*Attorney for Respondent*
*Oppenheimer & Co.*
80 Pine Street
New York, New York 10005

In The

# Supreme Court of the United States

October Term, 1975



No. 75-660

L. JOHN JACOBI and ROBERT GAMBERA, individually, on behalf of the members of the AMERICAN ASSOCIATION OF SECURITIES REPRESENTATIVES, and on behalf of all other securities representatives similarly situated,

*Petitioners,*

*vs.*

BACHE & CO., INC., WALSTON & CO., INC.; THOMSON & McKINNON AUCHINCLOSS, INC. (formerly THOMSON & McKINNON, INC.); HORNBLOWER-WEEKS, HEMPHILL, NOYES; LOEB, RHOADES & COMPANY; TUCKER, ANTHONY & R. L. DAY; HARRIS, UPHAM & CO., INC.; DOMINICK INT'L. CORP.; HALLE & STIEGLITZ, INC.; GOODBODY & CO., INC.; BEAR, STEARNS & CO.; LEHMAN BROS.; KIDDER PEABODY & CO., INC.; R.W. PRESSPRICK & CO., INC.; DEAN WITTER & CO., INC.; W.E. HUTTON; REYNOLDS & CO.; PAINE, WEBBER, JACKSON & CURTIS; SCHEINMAN, HOCKSTIN & TROTTA, INC.; PRESSMAN FROLICH & FROST, INC.; NEWBURGER, LOEB & CO.; RAUSHER, PIERCE SECURITIES CORP.; OPPENHEIMER & CO.; STEINER ROUSE & CO., INC.; L. F. ROTHSCHILD & CO.; SPENCER TRASK & CO.; SMITH BARNEY & CO., INC.; and THE NEW YORK STOCK EXCHANGE, INC.,

*Respondents.*

## REPLY TO BRIEF IN OPPOSITION

ABRAHAM E. FREEDMAN
*Attorney for Petitioners*
346 West 17th Street
New York, New York 10011
(212) 929-8410

CHARLES SOVEL
*Of Counsel*

(8868)

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*Respondents.*

## REPLY TO BRIEF IN OPPOSITION

Respondents, in their Brief in Opposition, do not deny that the NYSE Rule prohibiting payment of commissions based on the service charge would be a *per se* violation of the antitrust laws if adopted in a non-regulated industry. Rather, they rely on *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963), as supporting the contention that *per se* rules of antitrust liability do not apply to the securities industry even in those instances where there is no basis for antitrust immunity. As we have pointed out in our Petition, the reference to the "aegis of the rule of reason" in *Silver* was in the context of a discussion of those considerations which would lead to a finding of antitrust *immunity*, and simply have no application once the court has concluded, as the Court of Appeals did in the instant case, that there is no basis for conferring antitrust immunity.

Perhaps the best answer to respondent's argument, however, lies in this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117 (1973). There the question before this Court was whether a Rule of the New York Stock Exchange which required Registered Representatives to submit disputes with their employers to arbitration preempted a law of the State of California which provided that agreements to arbitrate such disputes did not preclude private suits in the courts. This Court held that the requirement that such disputes be submitted to arbitration was not necessary for "investor protection" and, therefore, did not preempt state law. Of particular significance to the instant case is the fact that the particular Rule involved in *Ware* was Subsection (b) of Rule 347 of the New York Stock Exchange Rules and Regulations, while the dispute in the instant case arises from the NYSE's failure to amend Subsection (a) of the very same Rule 347 to authorize



payment of commissions based on the service charge.* Rule 347 deals generally with the relationship between member firms and their Registered Representatives, and this Court's approach to Rule 347, as demonstrated in the *Ware* opinion, totally refutes the respondents' contention that the rule prohibiting the payment of commissions based on the service charge was a "reasonable" means of serving the purposes of the securities laws. This Court stated, in *Ware*, 414 U.S. at 135:

> "To begin with the obvious, there is nothing in the Act and there is no Commission rule or regulation that specified arbitration as the favored means of resolving employer-employee disputes. It is also clear that Rule 347(b) would not be subject to the Commission's modification or review under §19(b). The United States, as amicus, concedes as much, and we conclude, as the Government suggests, that *the relationship between compulsory employer-employee arbitration and fair dealing and investor protection is 'extremely attenuated and peripheral, if it exists at all.'*" (Emphasis supplied.)

However, "attenuated and peripheral" may have been the relationship between compulsory arbitration and investor protection in the *Ware* case, there is absolutely no relationship between the rule prohibiting payment of commissions based on

* A proposed amendment to Rule 347(a), which would have permitted the payment of commission based on the service charge, actually was drafted by a staff employee of the NYSE but was not submitted to the NYSE Board of Governors (28a).

the service charge and investor protection in the instant case. In fact, the Court of Appeals below recognized the non-existence of this relationship when it stated:

> "It is rather strong medicine to seek to spell out SEC sanction of the enforced omission of the service charge as a basis on which the compensation of registered representatives could be computed under employment agreements when the SEC consistently attempted to stay out of the controversy. More importantly, whereas §19(b) includes 'the fixing of reasonable rates of commission, interest, listing, and other charges' among the illustrations of the sort of matters on which the SEC can request changes in the rules and practices of exchanges, salary arrangements are not specifically included. *It would hardly be suggested that if NYSE prescribed a uniform method by which all member firms must compensate registered representatives, or even if it were only to set maximum compensation provisions, and filed rules embodying this with the SEC, that body could grant complete antitrust immunity. Immunizing such an agreement from the antitrust laws would not be 'necessary to make the Securities Exchange Act work.' Silver, supra, at 357; to the contrary, it 'would defeat the congressional policy reflected in the antitrust laws without serving the policy of the Securities Exchange Act.' id. at 360. Even regulatory agencies with express power to grant antitrust immunity have not been authorized to do this in respect of agreements with employees.*" (Emphasis supplied) (13a).



The holding of the court below that there was no antitrust immunity necessarily carried with it the conclusion that there was no basis under the securities laws for finding that the regulation was a reasonable means of implementing the policies of the securities laws. There is no rational way that a New York Stock Exchange regulation can be found to be a reasonable means of implementing the purposes of the securities laws without also finding that it falls within the scope of the Exchange's antitrust immunity. Conversely, there is no rational basis on which one could conclude that the securities laws require the abandonment of traditional *per se* concepts of antitrust liability in a case where it already has been determined that the policies of the securities laws do not require the conferring of antitrust immunity. The holding below that *per se* rules of antitrust liability are generally displaced in the securities industry, even in those areas where there is no antitrust immunity, finds no support in logic, in policy, or in this Court's prior decisions.

Respectfully submitted,

s/ Abraham E. Freedman
*Attorney for Petitioners*

Charles Sovel
*Of Counsel*